NO. 15156

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

R. H. PHILLIPS and JESSIE E. PHILLIPS, his wife, R. R. HAGGERTY and WINNIE HAGGERTY, his wife, and D. EVERETT PHILLIPS and EVELYN PHILLIPS, his wife, individually and in behalf of the Cold Creek Company, a partnership.
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

No. 15156

APPELLANTS' REPLY BRIEF

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I

The Court improperly rejected Exhibits 96 and 97, as well as the offer of proof of further evidence, written and oral, that would have established a value to appellants' mineral estate and leasehold interests, contrary to main contention disclosed by appellee's brief.

1. *The Trial Court's Ruling Was Arbitrary, Prejudicial and Seemingly Preconceived.*

The record discloses that, prior to any testimony, the trial court stated to counsel its position with regard to the admission of evidence as to mineral values, saying in part:

> "Unless the land is a proved field or reasonably adjacent to a proved field, *which isn't the situation here,* that mineral value, as such, cannot be made the basis of compensation, unless there can be shown reasonable probability that they exist there. And having been through these cases before, *I don't think it is possible* to show reasonable probability of gas and oil values under these lands." R. 89.

Appellants' presentation of their case was of course prejudiced by the trial court's erroneous adoption of the reasonable proximity and the "reasonable probability" rules. (See Brief for Appellants, p. 23-25). But equally as important, the trial court's statements clearly indicated that it had predetermined the matter of admission as to mineral values.

The fact of material values in mineral rights was not conceived after the declaration of taking, as inferred by appellee and the lower court, but on the contrary was born of actual major oil company leases, options and rental payments to the appellants. All of this preceded the declaration of taking. Rejected Ex. 96, 97.

Certainly a contractual rental income such as the offer of proof encompassed cannot be, prima facie, so speculative as to excuse the lower court's arbitrarily deciding the jury fact of presence or absence of value against the landowner, without permitting the introduction of any

evidence whatsoever. Both the trial court, R. 253-254, and counsel for appellee, R. 91, expressed great concern that an error in the form of evidence of a speculative nature might slip into the record. Yet after the admission of appellants' projected evidence, the trial court could certainly, and without insuperable difficulty, protect both itself and the parties by proper instructions, thus minimizing the possibility that "the case would be upset in the Court of Appeals." (Trial Court's ruling as to rejection of Evidence, R. 254).

A preconception of no value, as expressed by the trial court prior to the trial of the cause, and as reflected in its rejection of evidence without hearing testimony, is not a proper exercise of judicial discretion, and constitutes an invasion of appellants' constitutional right to their "day in court."

2. *Appellants' Offer of Proof Was Sufficient.*

The appellee has questioned the sufficiency of the offer of proof made by appellants. (Appellee's Brief, p. 6-10). Generally, of course, an offer of proof must be sufficient to advise the trial court so that it can understand what is sought to be shown. In the instant case there can be no question but that the trial court was fully advised by the offer of proof. In fact, the Court itself had suggested that the formal offer be deferred to the conclusion of the presentation of the appellants' case. The Court and counsel discussed the form of the offer of

proof, R. 236, 237, and the Court agreed that Mr. Swanson, on behalf of the appellants, could make the offer "as a whole" rather than by relating specific facts to specific witnesses, and that "it doesn't make any difference" to the trial court. R. 237. It was stipulated that it would be unnecessary to call the individual witnesses to the stand and that appellants' rights would be fully preserved by Mr. Swanson's making the offer of proof without putting on witnesses. R. 236. The Court clearly indicated that it was fully advised as to the nature of the evidence offered and the purpose for which it was being offered. R. 252, 253. No objection was made to the form of the offer of proof. The fact that it was largely generic rather than specific in nature was approved by the trial court, R.236-237, and agreed upon by counsel, who made no motion to make more definite. Counsel for appellants was in a situation somewhat similar to that referred to in the case of *Bates v. Oregon-American Lumber Co.*, 295 Fed. 1, at p. 6, where "the Court indicated its mind was made up that no such proof could be made; that is to say, the offer of proof was reduced to a mere formaltiy." R. 89, 252-253.

3. *Lower Court Misinterprets Pertinent Rules Pronounced By Ninth Circuit.*

The real question before the Court is whether the trial court, after being continually advised throughout the trial that appellants intended to establish the value of their mineral estate and the value of their mineral lease-

holds as an "element of value" in determining a true market value, committed error in refusing appellants an opportunity to prove their case by competent testimony and exhibits. Appellants sought the introduction of Exhibit 96, the option to lease, and Exhibit 97, the Shell Oil Company lease, R. 207-210. These documents on their face would have established that appellants were receiving twenty-five cents an acre per year for mineral leases then in effect, together with the probability of continued revenue in the future. Granted, both documents were in form subject to cancellation, but so are most leases written by major oil companies. The mere fact of the possibility of cancellation does not negate value. In *U. S. v. Jaramillo,* 190 F. (2d) 300 (Tenth Circuit) it was held that it is proper for the jury to consider cancellable rights, provided also that consideration is also given to the possibility that the rights might be withdrawn.

In addition, if the appellants had been permitted to proceed in a proper manner with the introduction of evidence, they would have introduced evidence of every transaction involving mineral leases of major oil companies as to the area in question. R. 239. The introduction of such evidence through Mr. Valentine of Shell Oil Company would necessarily establish the rental payments under said leases and the fact that the subject lands were a part of an increasingly active leasing area. Through the testimony of Mr. Beam of Carter Oil Company, now consultant to the Northern Pacific Railroad Co., a value as to

the mineral estate underlying the leasehold interests would have been developed. R. 240. Certainly, Mr. Beam and Mr. Valentine could qualify as experts for the purpose of giving testimony relative to the actual value of the mineral interests of the appellants.

When an offer of proof is rejected, it must be presumed that the party making said offer was able to prove what he offered to prove. *Tilley v. Cook County,* 103 U. S. 155, 26 L. Ed. 374. In the instant case, the trial court, even though it necessarily must have assumed that all the facts set forth in the proffers could be and would be proved, still ruled against the admission of said evidence, basing said ruling on its erroneous interpretation of the law.

The trial court stated as follows:

> "In Texas and under Texas law a mineral lease is recognized by law as being property having a market value even if it covers undeveloped territory, and I submit this is not the law in this jurisdiction." R. 251.

This in fact is the law of this jurisdiction, as set forth in the case of *Cal-Bay Corporation, et al v. United States,* Ninth Circuit, 169 F. (2d) 15. The trial court further emphasizes its error by stating further that since "this land is not *in or anywhere near a commercially producing mineral area,* gas and oil area, that allowing a jury to place a valuation on mineral rights or on the right to lease it for prospecting for gas and oil would be too speculative and remote to form the basis for compensation." R. 252-

253. It therefore is apparent that the trial court rejected the offers of proof, not because material values could not be shown, but because the mineral interests related to an "undeveloped territory" and "not in or anywhere near a commercially producing mineral area, gas and oil area," R. 253, and further that in the Court's opinion, it was not possible to show "reasonable probability of gas and oil values."

The trial court's own language, tested by the law of *Eagle Lake Improvement Co. v. United States,* 141 F. (2d) 564, and *Cal-Bay v. United States, supra,* points out clearly that the Court erred in its interpretation and application of the law of the Ninth Circuit.

4. *Appellants' Leasehold Interests Are Ascertainable Elements of Value in Determining True Rental Value.*

Every mineral acre owned by appellants was under contract, 26,000 acres in all. Ex. 96, 97. This could not be an instance of "probable future profits based upon conjecture," *Murdock v. United States,* 160 F. (2d) 358, 360, but a definite contractual value existing prior to the declaration of taking. The value of appellants' right to lease was a minimum of 25c per acre or $6,500.00 a year. This element of value should have been submitted to the jury for their consideration in the assessment of market value. Otherwise, how could one say that the appellants have received "the full and perfect equivalent in money for the property taken," *United States v. Miller,* 317 U. S.

369, as to all the elements of value that inhere in the property. An annual income of $6,500 is a material asset deserving of appraisal consideration.

5. *Offer of Proof Would Have Established Definite Probability of Mineral Values, and Consequent Value to Appellants' Mineral Royalties.*

The appellants' offer of proof included the testimony of head geologist, Mr. Valentine, of Shell Oil Company, that the existence of gas and oil in the area, including the subject lands, is probable, based upon presence of the factors on the condemned land which indicate the existence of gas or oil. R. 239. Appellee's contention that "no attempt was made even to show a chance geologically of commercial oil discovery" (Appellee's Brief, p. 12) is therefore untrue. It should be emphasized that appellants were not required by the trial court to make a detailed offer of proof. Appellants' offer of proof clearly encompasses the question of probability or possibility of oil or gas in commercial quantities.

Once the probability or even the possibility of oil or gas under the subject lands is established by competent evidence and testimony, the retained 12½% of the appellants' royalties under their leases to major oil companies would then have a real and ascertainable value. The rejected testimony of expert witnesses would have established the probability of oil beneath the subject lands, and

thereby would have proved an existing market value as to the retained mineral royalties.

6. *Active Leasing Area Establishes Market in Mineral Rights.*

The appellee in its brief asserts that the "basic defect in the offer of proof was a lack of showing an active market." (Appellee's Brief, p. 9). In the offer of proof appellants propose to show, by testimony and introduction of leases, "that this area does, therefore, constitute an active leasing area of common knowledge among oil people and owners of real estate." R. 239. Certainly, "an active leasing area" presupposes the existence of demand and a market in mineral leases and mineral rights. Logic dictates that you can't have one without the other. Every fact sought to be introduced by the appellants under their offer of proof would contribute to the proof of the existence of a market in mineral leases and mineral rights.

II

The error in exclusion of exhibits and testimony necessitates a new trial as to all four consolidated cases.

1. *The Rejected Evidence Precluded Jury From Determining All "Elements of Value" As to Appellants' Fee Interest.*

Appellee has been forced to adopt an inconsistent position with regard to the question of whether or not the mineral interests are severable from the remaining fee interest. On page 8 of its Brief, appellee cites authority

that "even when there were outstanding mineral leases . . . the owners of mineral interests were not entitled to a separate trial and that evidence of market value of the whole property was admissible." Appellee then takes an inconsistent position in asking that even though there was error, the re-trial should be limited to mineral values. Appellee's Brief, p. 14. The appellants, by stipulation with the government, sought to separate mineral values from the remaining value, but this was refused. R. 92. The mineral values cannot now be separated. The error is necessarily one that affects Civil Case No. 892 in its entirety in that mineral values are additional "elements of value" in determining reasonable market value of appellants' fee interest.

2. *Rejection of Proffers Substantially Reduces the Jury Verdicts As to the Three Leasehold Cases.*

Appellee's Brief states categorically that "the mineral claim has no connection with the three leasehold cases." This statement is not supported by logic or fact. The absence of testimony as to income from appellants' mineral leases has a direct effect on the market value of leasehold interests as to Civil Cases 452, 488 and 762. Rent from agricultural use is no better than rent from mineral leases in determination of a rental verdict.

Inasmuch as Appellee's Brief indicates a lack of understanding as to the leasehold cases, a brief summary seems in order.

The annual agricultural rental values of said condemned leaseholds were fixed by appellee's chief appraiser, C. Marc Miller, as follows: (R. 124-128).

Civil Case No. 452—4,086.69 acres—$1,225.00 annual rental, or approximately 30c per acre.

Civil Case No. 488—3,034.84 acres—$759.00 annual rental, or approximately 25c per acre.

Civil Case No. 762—6,868.22 acres—$1,370.00 annual rental, or approximately 20c per acre.

The alleged average annual rental per acre for all of the condemned property is less than 24c per acre. Therefore if the rejected exhibits 96 and 97 had been admitted, and oral testimony permitted, it would have been established that as to 1,685.60 acres of the above property, appellants had contracted to receive, and were receiving, 25c per acre for mineral rental in addition to alleged value for agriculture only. Inasmuch as C. Marc Miller had appraised the annual rental per acre at less than 25c, the jury, had they been permitted to consider the annual rental per acre then being received by appellants for mineral leaseholds, would have been compelled to at least double their verdict as to the leasehold condemnation of the above acreage.

The above mathematical computation clearly illustrates that the exclusion of evidence as to yearly payments under existing oil leases directly and prejudicially affected Leasehold Cases Nos. 452, 488 and 762.

CONCLUSION

Appellee asks the question, "How could the jury arrive at a dollar or cents figure for a mineral interest except by pure guess?" (Appellee's Brief, p. 5).

The answer is, the jury couldn't, for the reason that appellants were precluded from presenting the evidence that would have established substantial mineral values. The property owners should have been given a full opportunity to present their case and to prove all elements of value. The rejection of evidence by the trial court prior to submission would seem to contain an element of "guessing" on the part of the Court even more dangerous than the possible guess of a juror as referred to by the appellee.

Mineral royalties and mineral leases are rights of great benefit to the landowners throughout the United States whose properties are situate in geologically potential oil or gas bearing areas. The subject lands and surrounding area have been the scene of greatly increased activity on the part of major oil companies. (R. 52). The Northwest is a large consumer of oil products and gas, the oil products being hauled approximately 1,000 miles and the gas piped over 2,000 miles from producing areas.

"We think the courts are entitled to take notice of the condition and development of the petroleum industry," *Gilbreath v. State Oil Corp.* (C.C.A. 5), 4 F. (2d) 232,

233; see also *People v. Associated Oil Co.* (1930) 211 Cal. 93, 105.

The trial court has exceeded discretion in predetermining in effect that a potential oil field has no value until the day after oil or gas is surfaced. To so hold is to negate the value of modern geology and research.

The appellants should therefore be granted a new trial as to the entire cause.

Respectfully submitted,

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